
LAC Success Put to the Test

Universidad de los Andes – Programa de Alto Gobierno

Bogotá, Colombia
1 Septiembre 2011

***Chief Economist Office
Latin America and the Caribbean
The World Bank***

World
Bank  **LAC**
opportunities for all

Structure of the presentation

- LAC's success and the maturing recovery – real decoupling
 - The new face of LAC after a good decade
 - Maturing recovery cycle
 - Domestic policy tensions
- Rising global uncertainty and risks – financial coupling
 - European ailments: are sovereign debt troubles reaching the core?
 - U.S. downgraded: is a double-dip in the horizon?
 - China: how hard a landing?
- Whither LAC?
 - Can LAC avoid the traditional boom-bust pattern and achieve a high trend growth (real trend decoupling)?
 - How resistant is LAC macro-financial immune system to a potential downward cyclical financial *and* real re-coupling on a global scale?

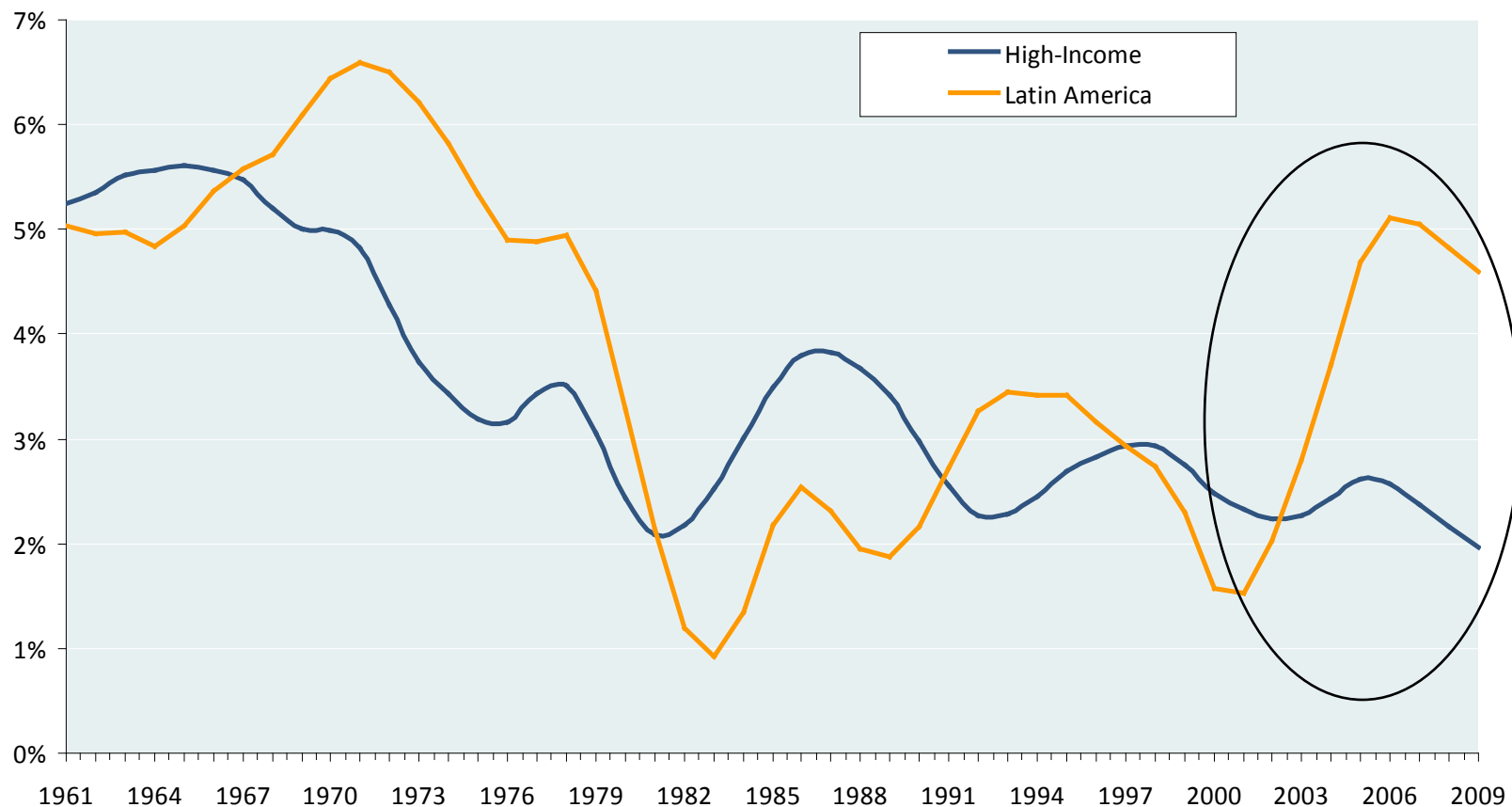
LAC's Success and the Maturing Recovery

LAC's success

Non-inflationary growth decoupling from rich countries

Cyclical-adjusted Growth in Latin America and High-Income Countries

Trend growth computed using the band-pass filter

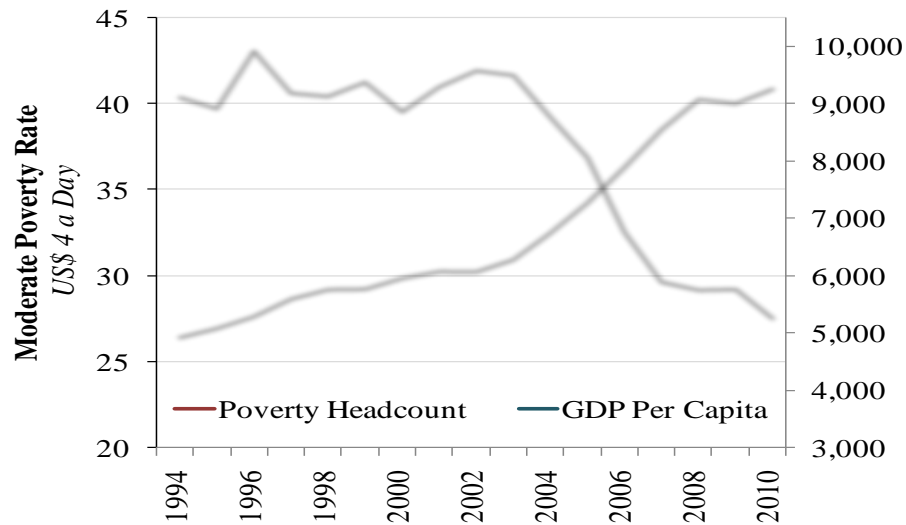


The trend growth of real GDP growth is computed using the band-pass filter (Baxter and King, 1999). LCRCE staff calculations. Source: WDI – World Bank; National Authorities.

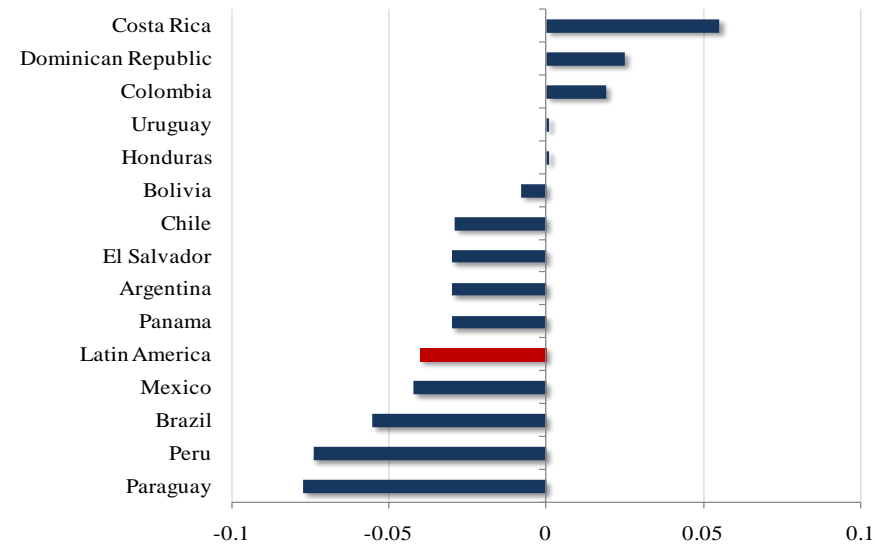
LAC's success

Reduction in poverty and income inequality

Per Capita GDP Growth and Poverty
LAC Countries

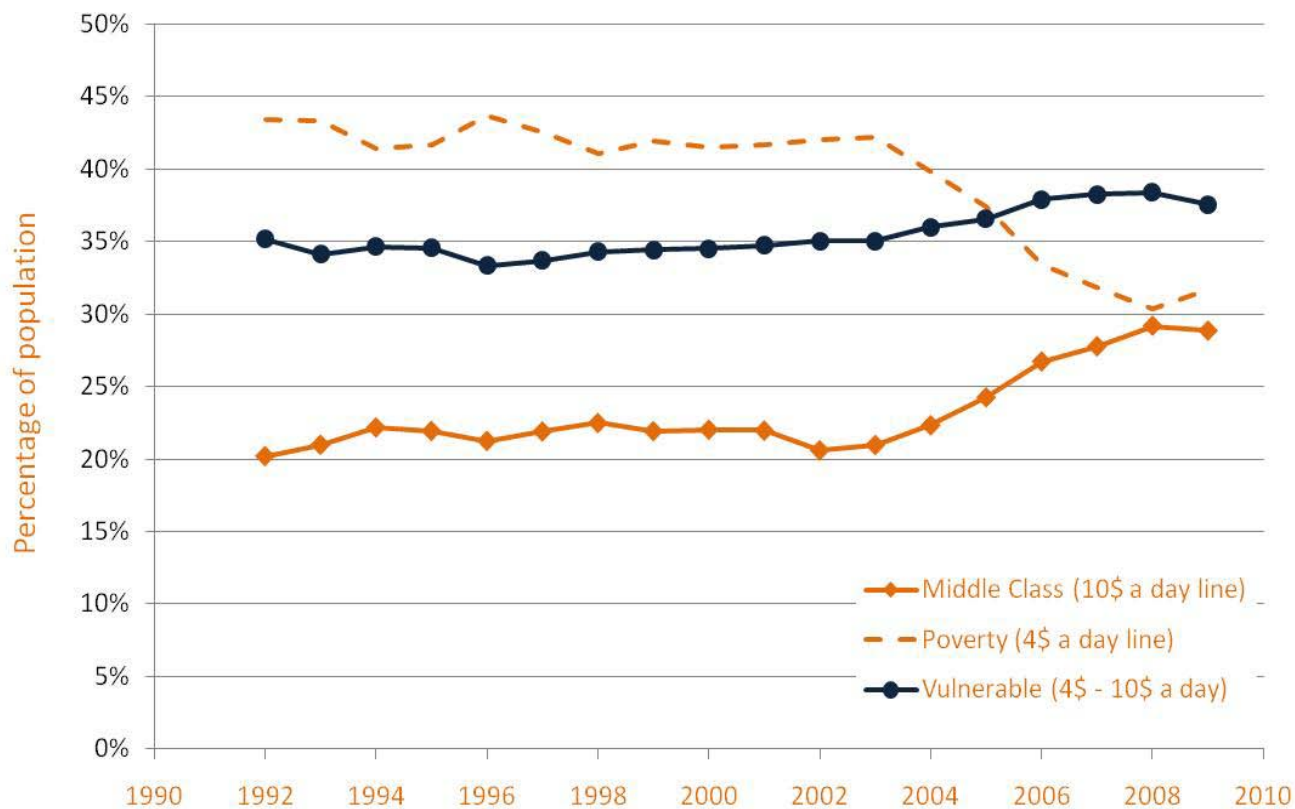


Gini Coefficient Cumulative Change
From 2009 to 1995



LAC's success

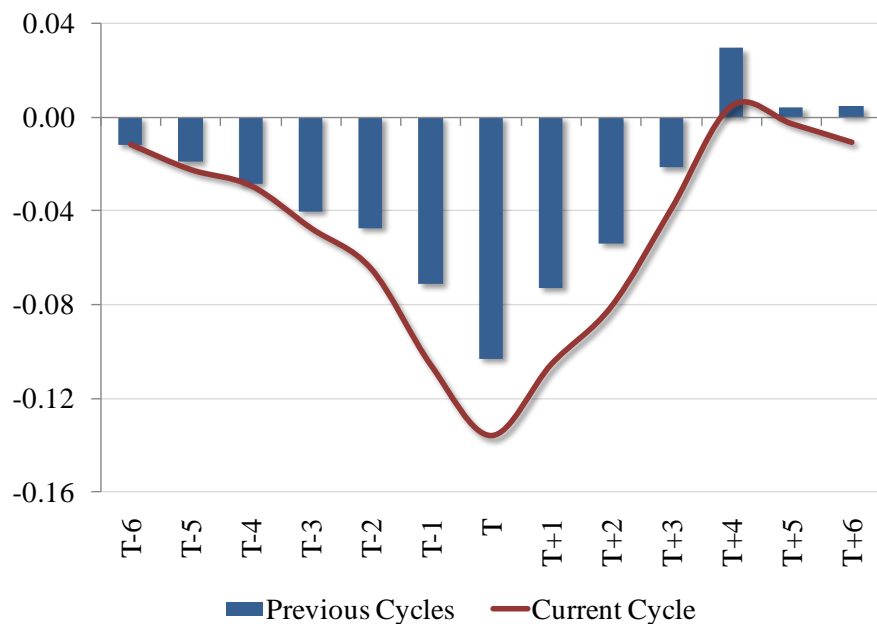
An expanding middle class



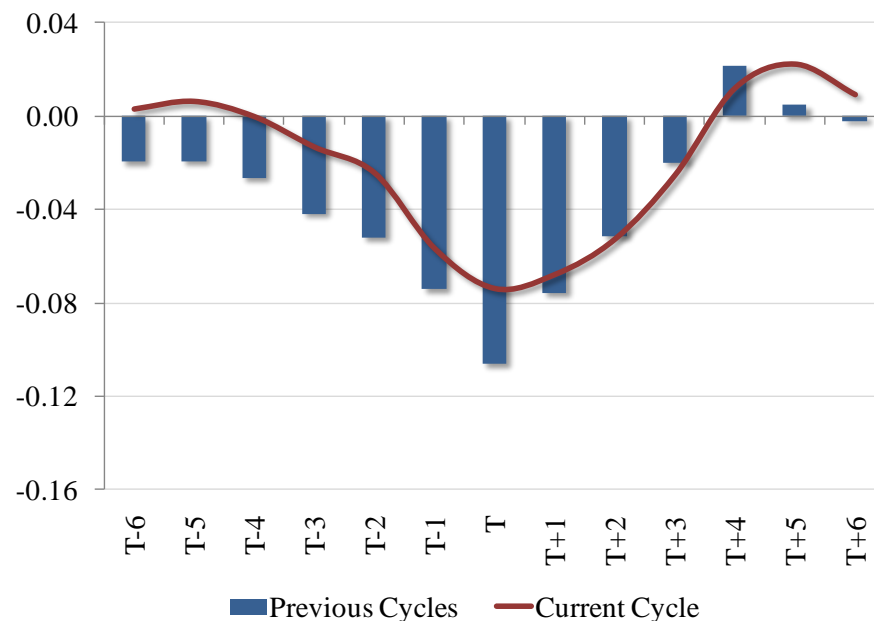
LAC's success

Stellar performance during the 2009 global downturn

Growth in Real GDP
Middle Income Countries



Growth in Real GDP
Latin America and the Caribbean



LAC came out of the global crisis without balance sheet damage

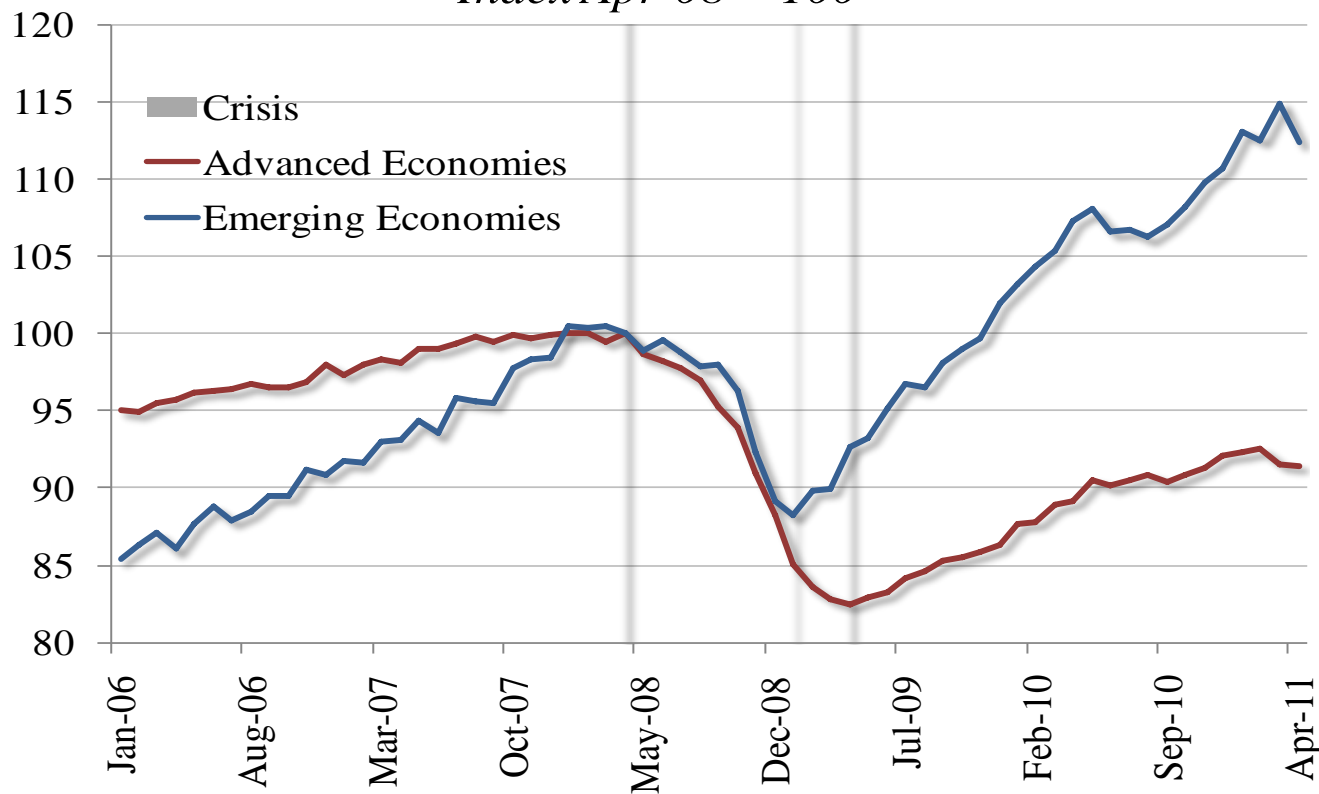
Notes: The figures represent the deviations from regional/group trend growth in real GDP on 13-quarter windows centered on previous and current troughs on real GDP. This figure depicts the behavior of real GDP in previous and current recession-recovery cycles. Sources: IMF's International Financial Statistics – IFS, National Statistical Institutes and Central Banks, Haver Analytics.

LAC's success

Joining the dynamic EMs in the recovery phase

World Industrial Production

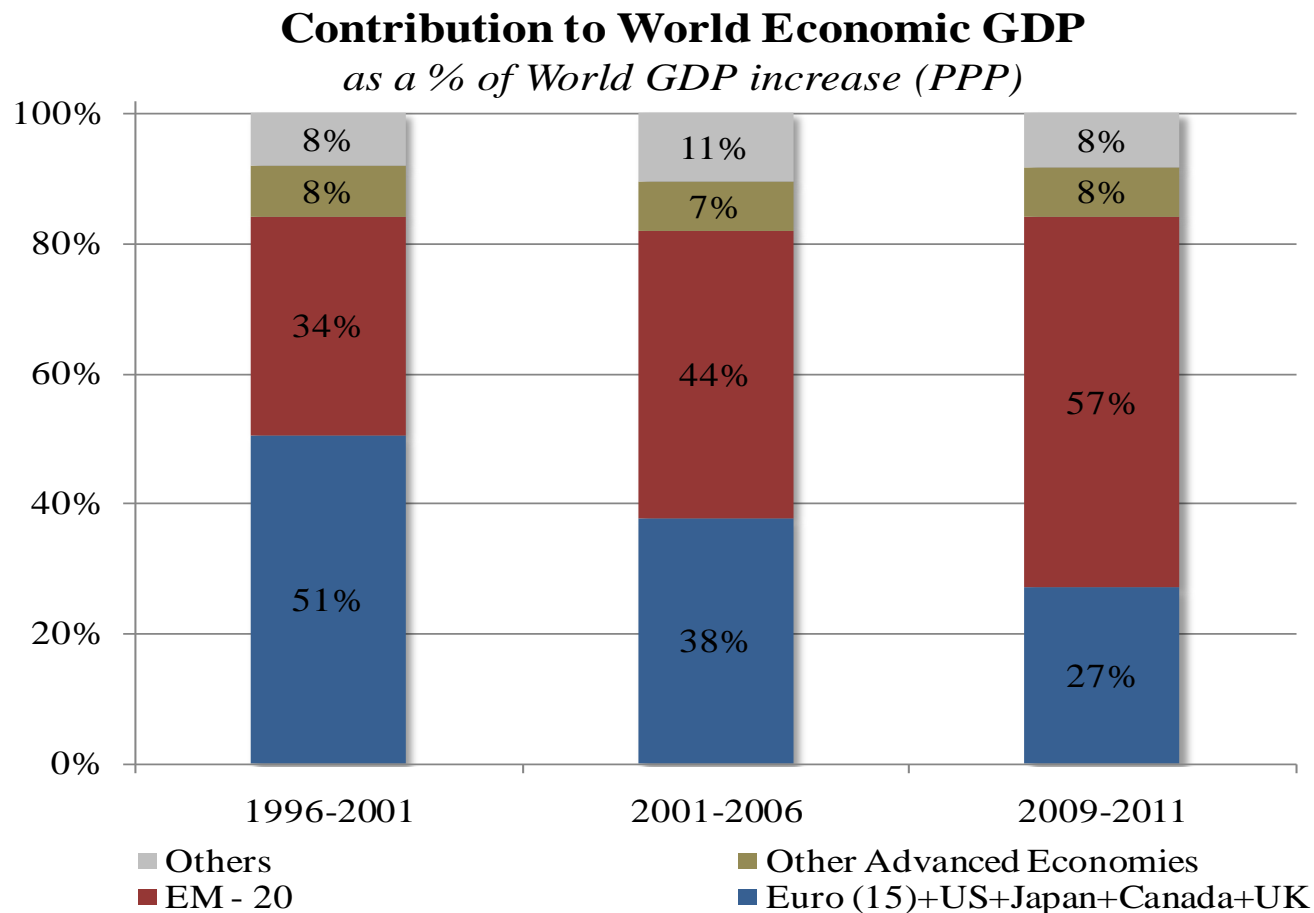
Index Apr-08 = 100



- *Emerging economies with strongest recoveries include Brazil, China, India, Korea, Malaysia, Philippines and Thailand*
- *They represent 52% of emerging economies' GDP*

LAC's success

Joining the EM family in the recovery phase

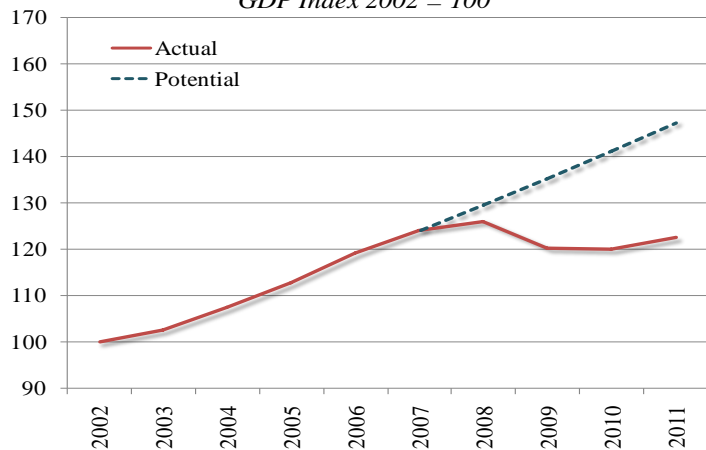


Note: The EM-20 economies are the 20 Emerging Economies with higher GDP PPP in 2011 within the Emerging Economies. They explain 81.9% of the Emerging Economies total GDP. The 20 economies are: China, India, Russia, Brazil, Mexico, Indonesia, Turkey, Iran, Poland, Argentina, Saudi Arabia, Thailand, South Africa, Egypt, Pakistan, Colombia, Malaysia, Nigeria, Philippines and Venezuela.

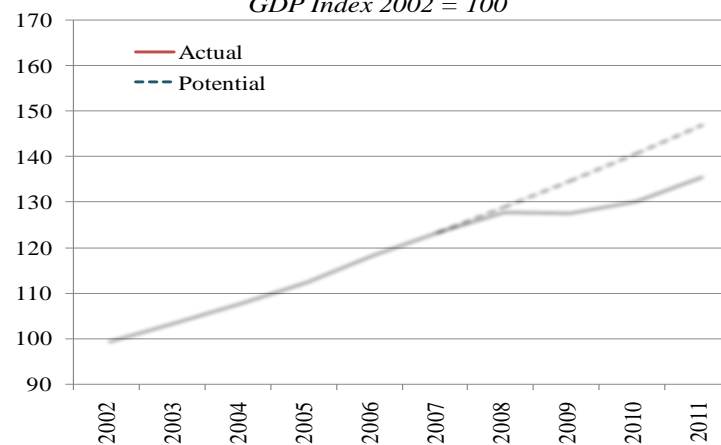
LAC's uneven success

Mutating regional heterogeneity

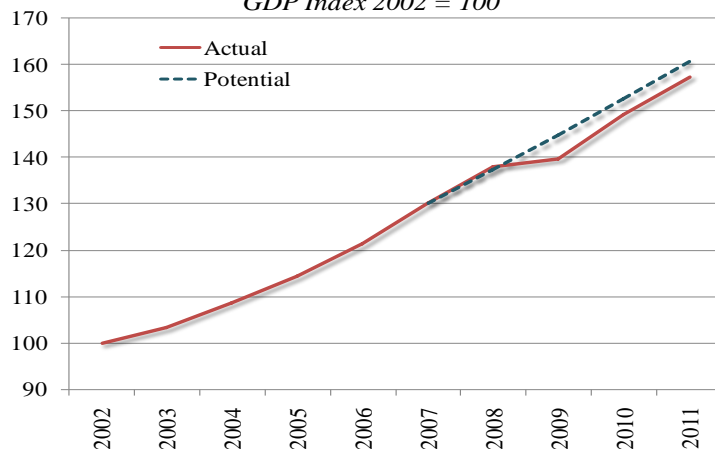
Slow-Growth Countries within LAC
GDP Index 2002 = 100



Medium-Growth Countries within LAC
GDP Index 2002 = 100



High-Growth Countries within LAC
GDP Index 2002 = 100



Sources: Potential GDP is computed as the average rate of growth between 2007 and 2003. Simple averages are used to construct the composite. The categorization of each group is as follow: Slow-growth are those countries that showed a less than 3.5% in their 2011-2008 GDP real growth rate; Medium-growth are those between 3.5% and 10%; High-growth are those with 10% or more. For 2011 we used the last available forecast (Consensus Forecast June-2011). Sources: Consensus Forecast (June – 2011); WEO (April – 2011).

LAC's uneven success

Where you are matters less than to whom you are connected

	Number of countries	Mean growth 2003-2007*	Mean Growth 2003-2011	Mean Growth 2008-2011**	Cumulative	
					Max. 2008-2011	Min. 2008-2011
<i>Low growth</i>	13	4.4%	2.3%	-0.3%	3.3%	-12.3%
<i>Medium growth</i>	7	4.4%	3.5%	2.4%	7.9%	4.1%
<i>High growth</i>	12	5.4%	5.2%	4.9%	18.8%	10.0%
Total	32	4.8%	3.7%	2.2%	18.8%	-12.3%

* This is the measure used to construct the "Potential GDP"

** This is the measure used to define the classification as "Low", "Medium" and "High".

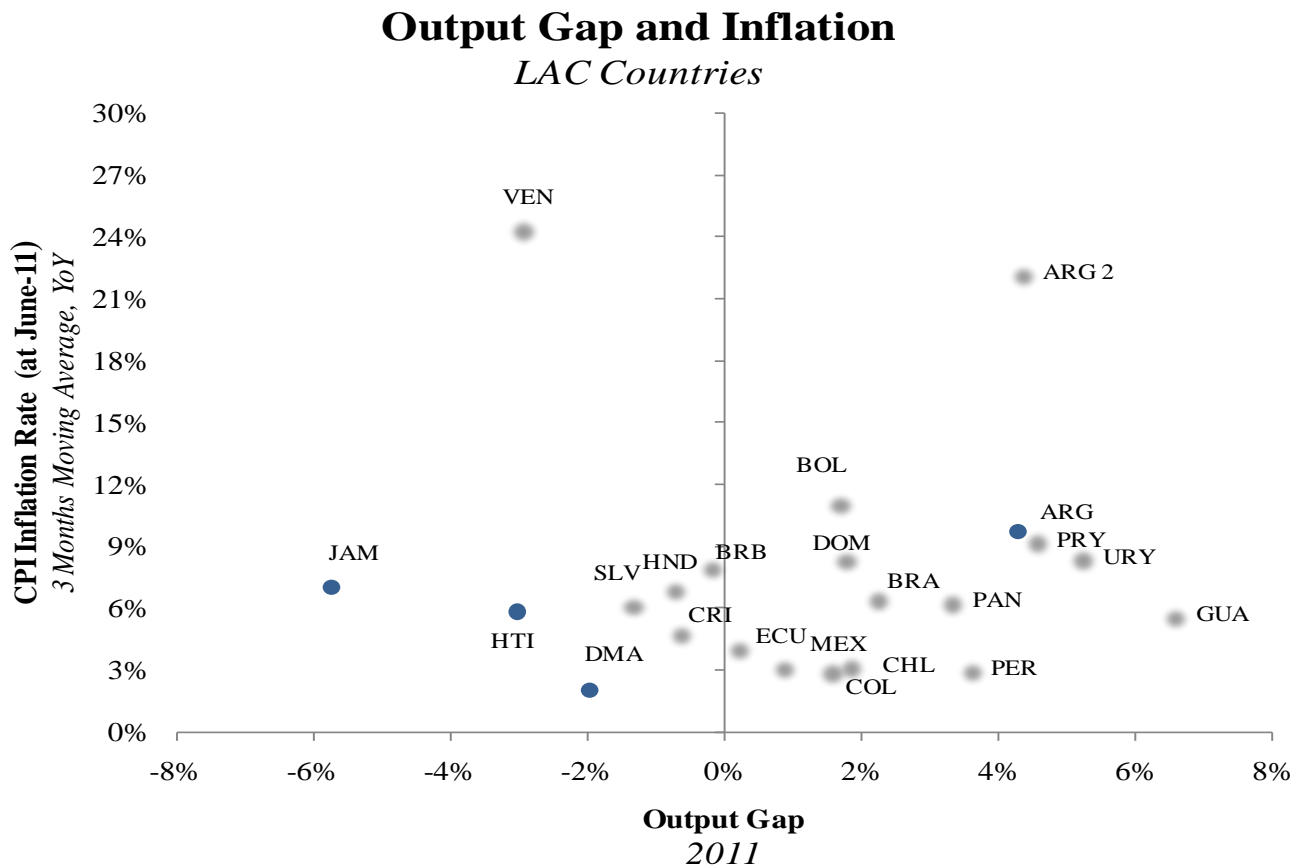
Low growth (<4%): St. Kitts and Nevis, Antigua and Barbuda, Grenada, Barbados, *Jamaica*, Bahamas, *Venezuela*, *Trinidad and Tobago*, St. Vincent and the Grenadines, El Salvador, St. Lucia, Dominica and *Mexico*

Medium growth (4%-10%): Honduras, Belize, Haiti, Nicaragua, Guatemala, Costa Rica and *Ecuador*

High growth (>10%): Chile, *Colombia*, Brazil, Guyana, *Bolivia*, Suriname, Paraguay, *Dominican Republic*, Peru, Argentina, Uruguay and *Panama*

LAC's maturing cyclical recovery

Overheating and *endogenous* inflationary pressures



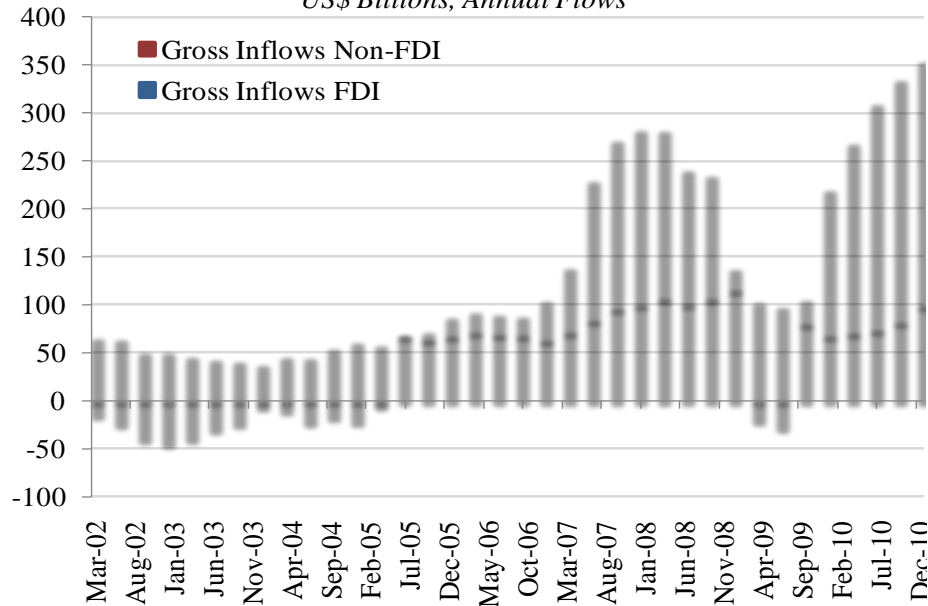
Notes: The area inside the box represents the range between the lowest and highest midpoints among inflation targeting countries. Sources: National Statistical Institutes and Central Banks, Haver Analytics.

LAC's maturing cyclical recovery

Double tail spin push: commodity prices & capital inflows

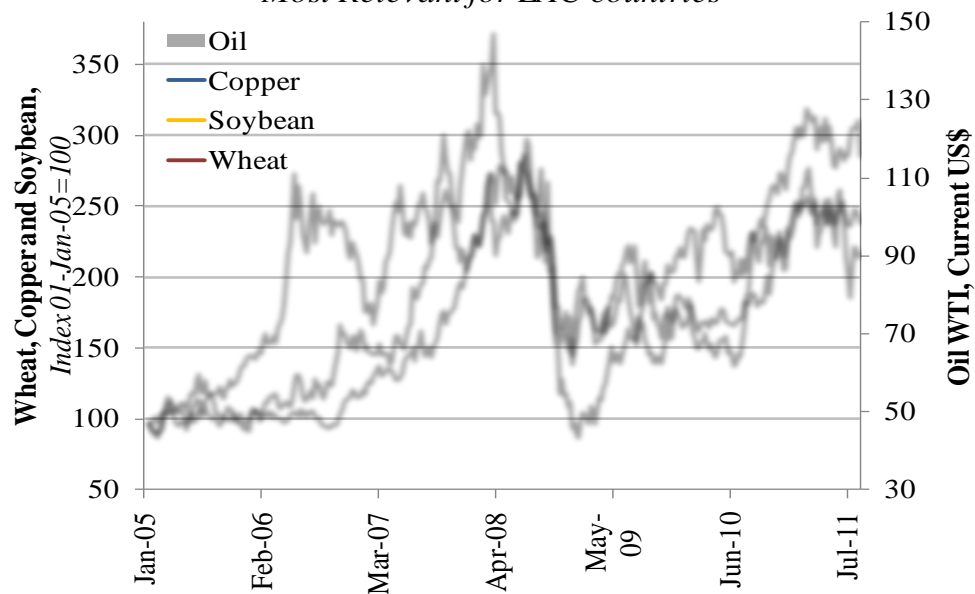
Gross Capital Inflows to LAC-7 Countries

US\$ Billions, Annual Flows



Commodity Prices

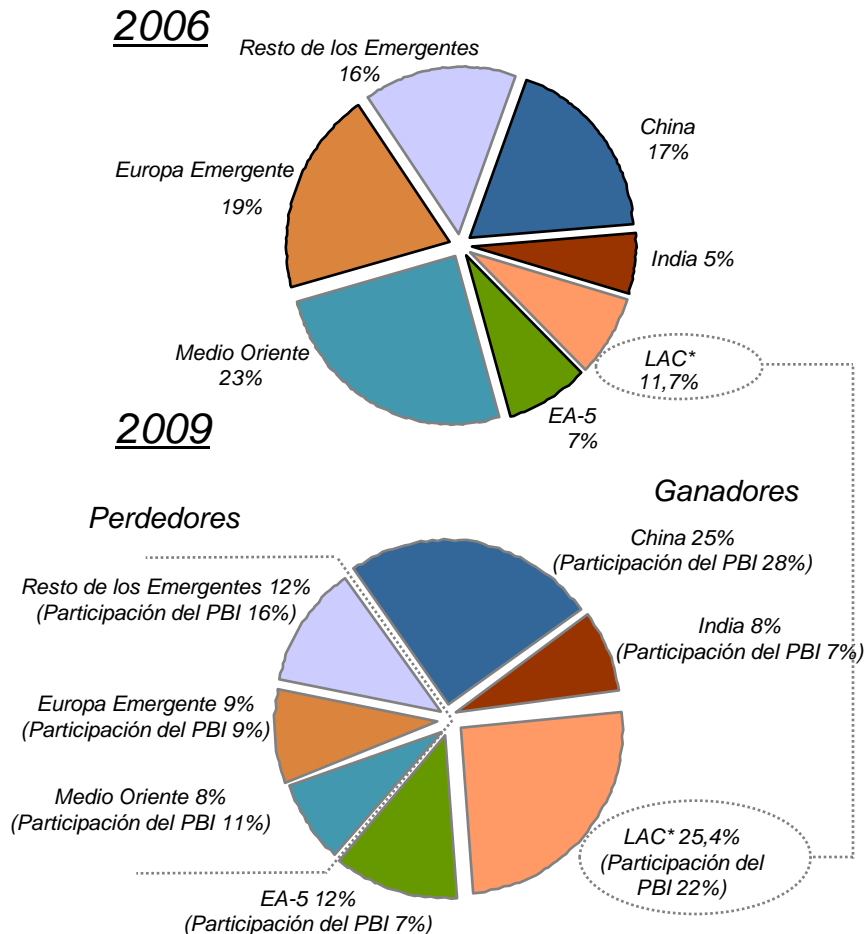
Most Relevant for LAC countries



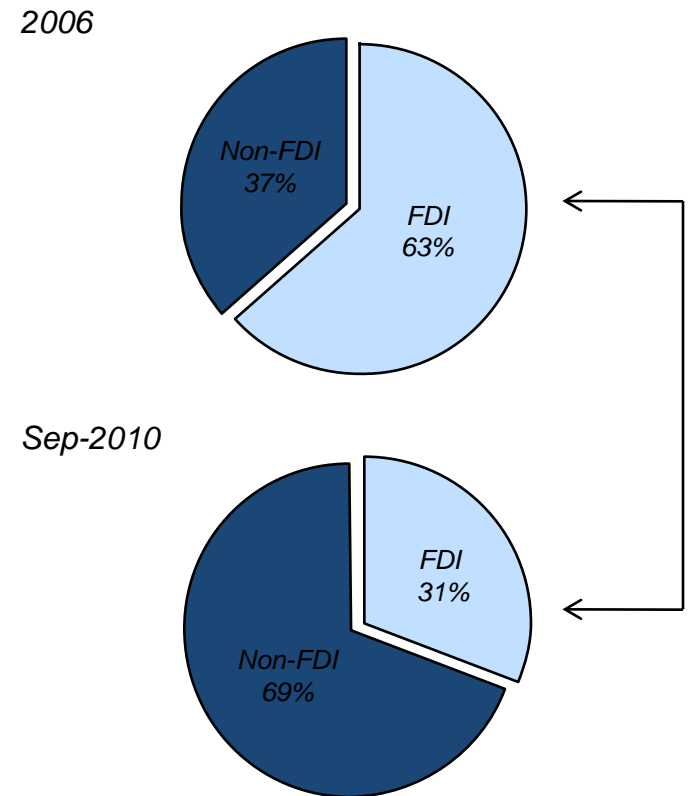
Notes: Annualized capital inflows to LAC-7. Sources: IMF's Balance of Payments Statistics, National Statistical Institutes, and Central Banks.

LAC gaining share in *non-FDI* flows to EMs

Distribution of Capital Flows to EMs



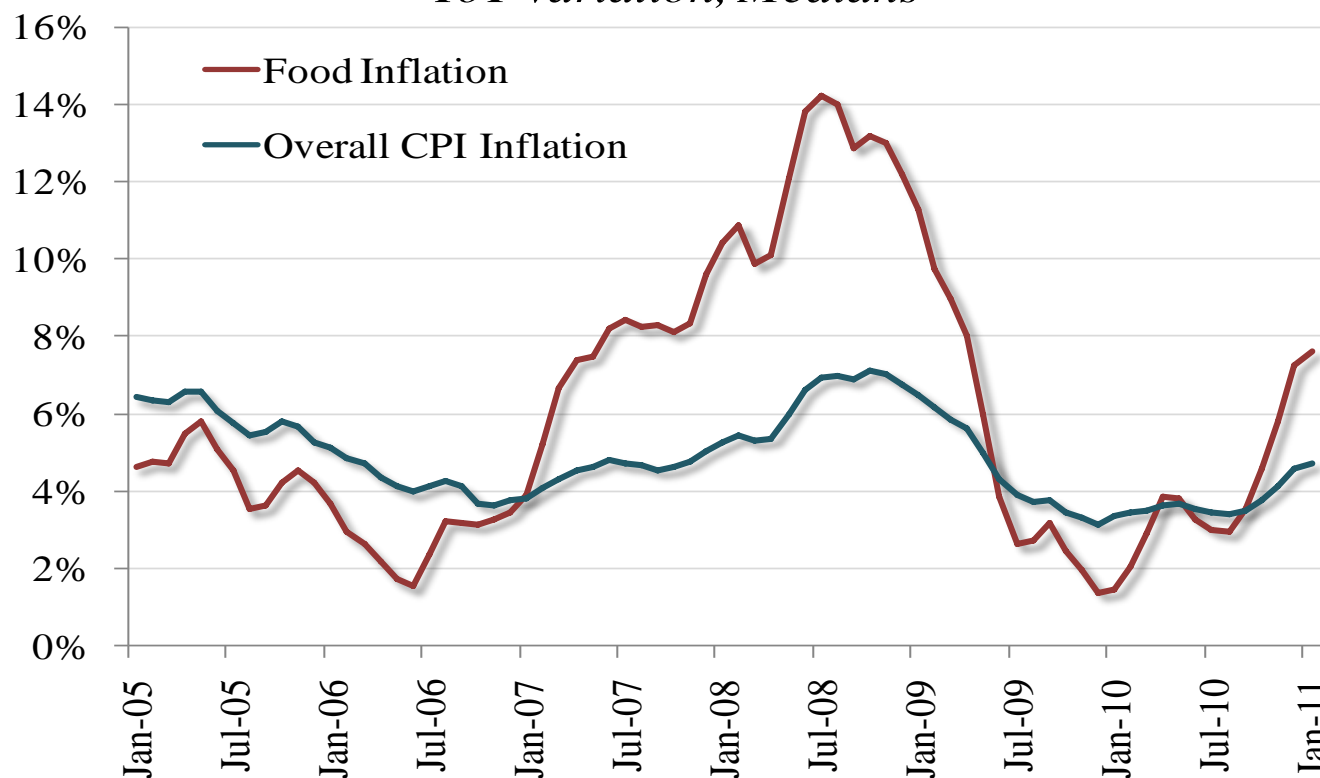
LAC-7: Composition of Capital Inflows



Demands on domestic macro-financial policy

Maintain inflation expectations well anchored

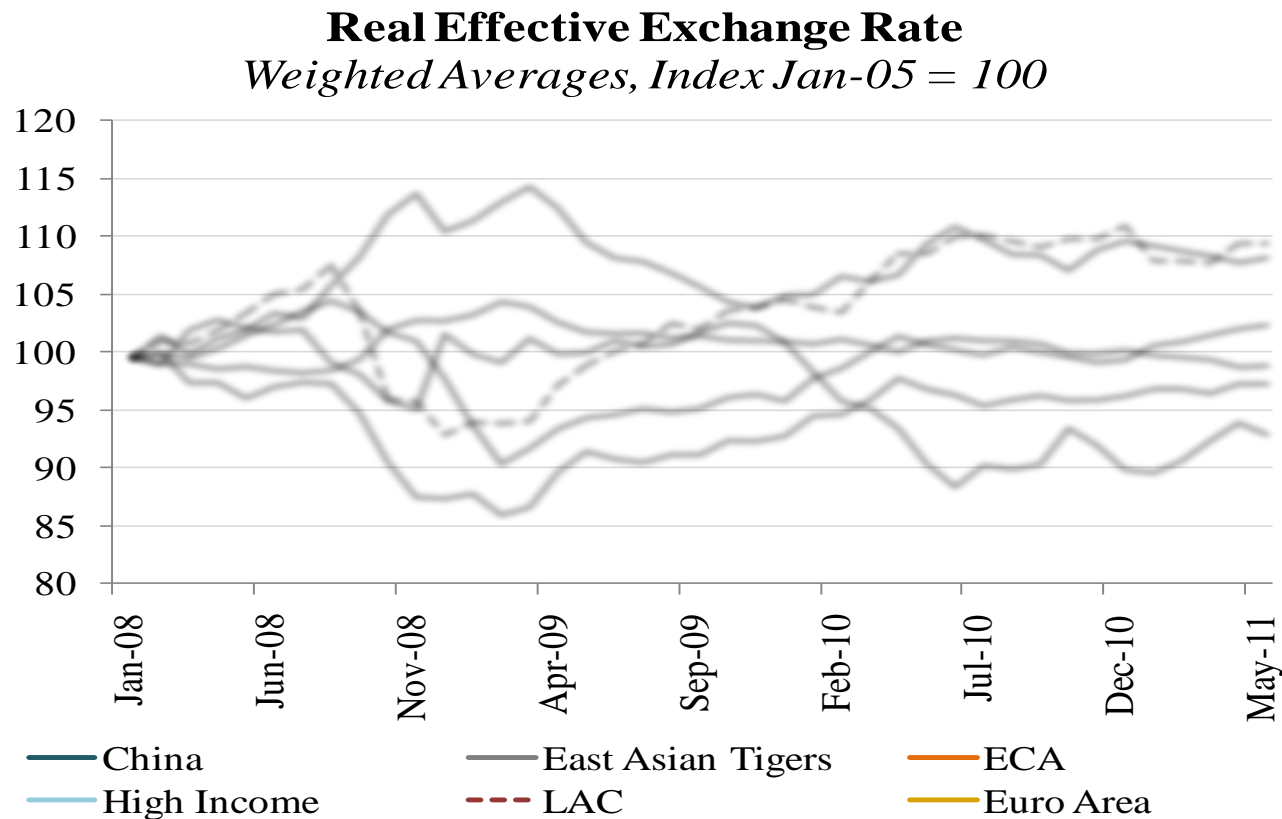
Food and Overall CPI Inflation : LAC-7 + URY
YoY Variation, Medians



Notes: There is a change in the methodology of calculation for both food and overall PCI index for Chile since January 2009. For the figure on the right, we used the latest available figure for each country. Weighted averages (2007 Nominal GDP in USD Billions) were used in the case of the regional numbers. Sources: Bloomberg, Instituto Nacional de Estadísticas de Chile – INE, and Food and Agriculture Organization – FAO (2010) and IMF's World Economic Outlook – WEO (October 2010).

Demands on domestic macro-financial policy

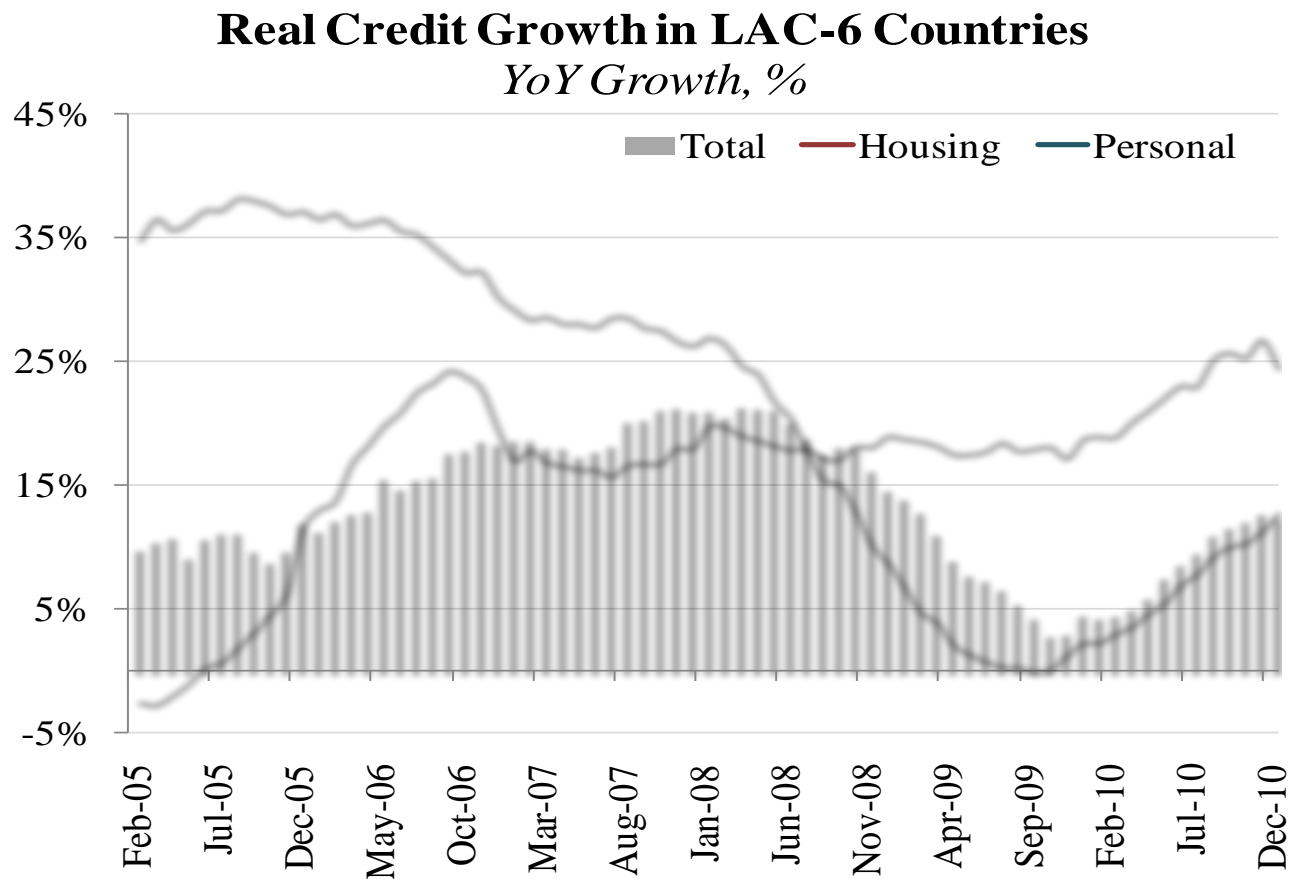
Avoid “excessive” currency appreciation



Notes: Weighted averages were calculated using the 2007 nominal GDP in USD Billions. An increase means an appreciation of the REER. Sources: IMF's International Financial Statistics – IFS and IMF's World Economic Outlook – WEO (April 2011).

Demands on domestic macro-financial policy

Curb systemic risk buildup (financial excesses)

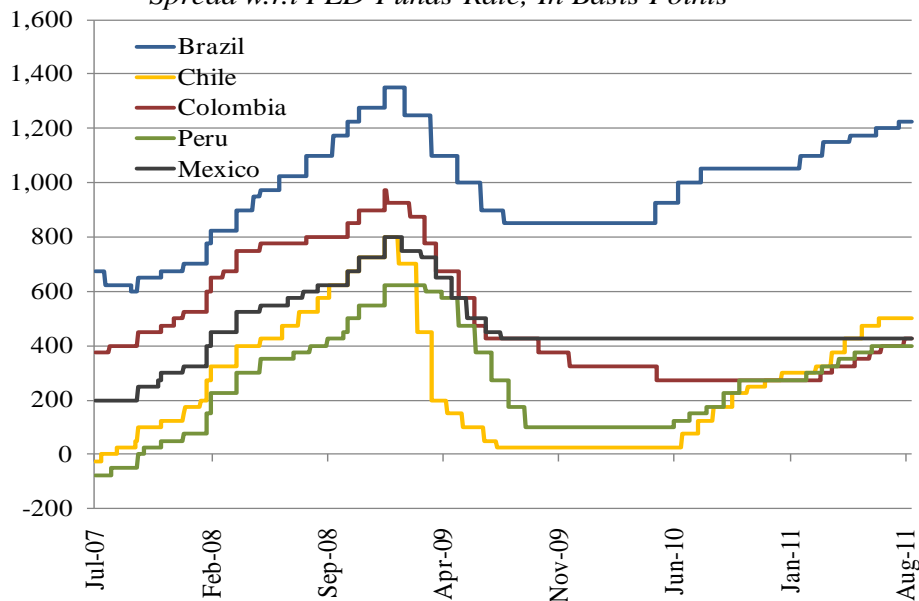


Notes: The figure depicts the (PPP-GDP) weighted average of the growth rates of (total, personal and housing) credit to the private sector for the six largest LAC countries (Argentina, Brazil, Chile, Colombia, Mexico, and Peru). Sources: National Statistical Institutes, Central Banks, and Superintendence of Banking.

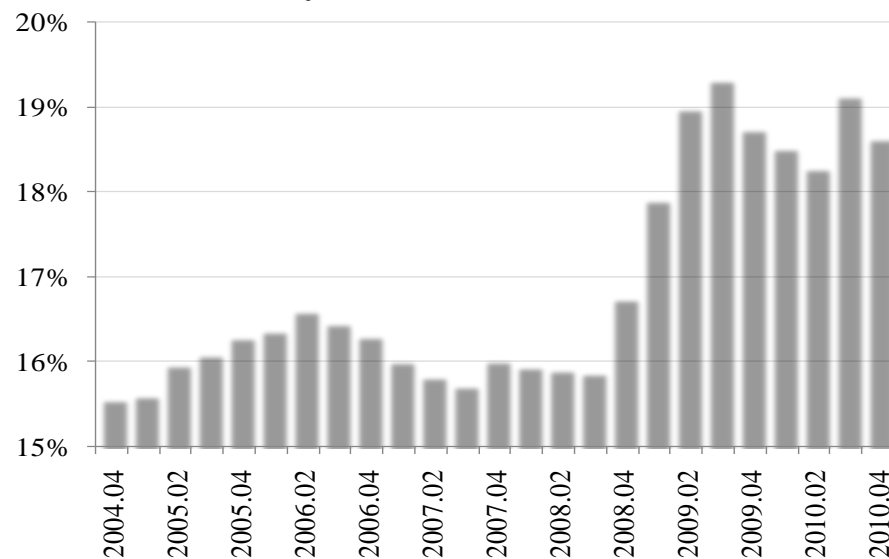
Adjusting the macro-financial policy response

The need to rebalance the monetary-fiscal policy mix

Monetary Policy Interest Rate Differential
Spread w.r.t FED Funds Rate, In Basis Points



Primary Expenditure
% of GDP, LAC-6 Countries



Notes: The figures in Panels B is the cyclically-adjusted primary expenditure and primary balance for the major six LAC countries (Argentina, Brazil, Chile, Colombia, Mexico, and Peru). Sources: Bloomberg, Haver Analytics, National Statistical Institutes, and Central Banks.

Domestic macro-financial policy

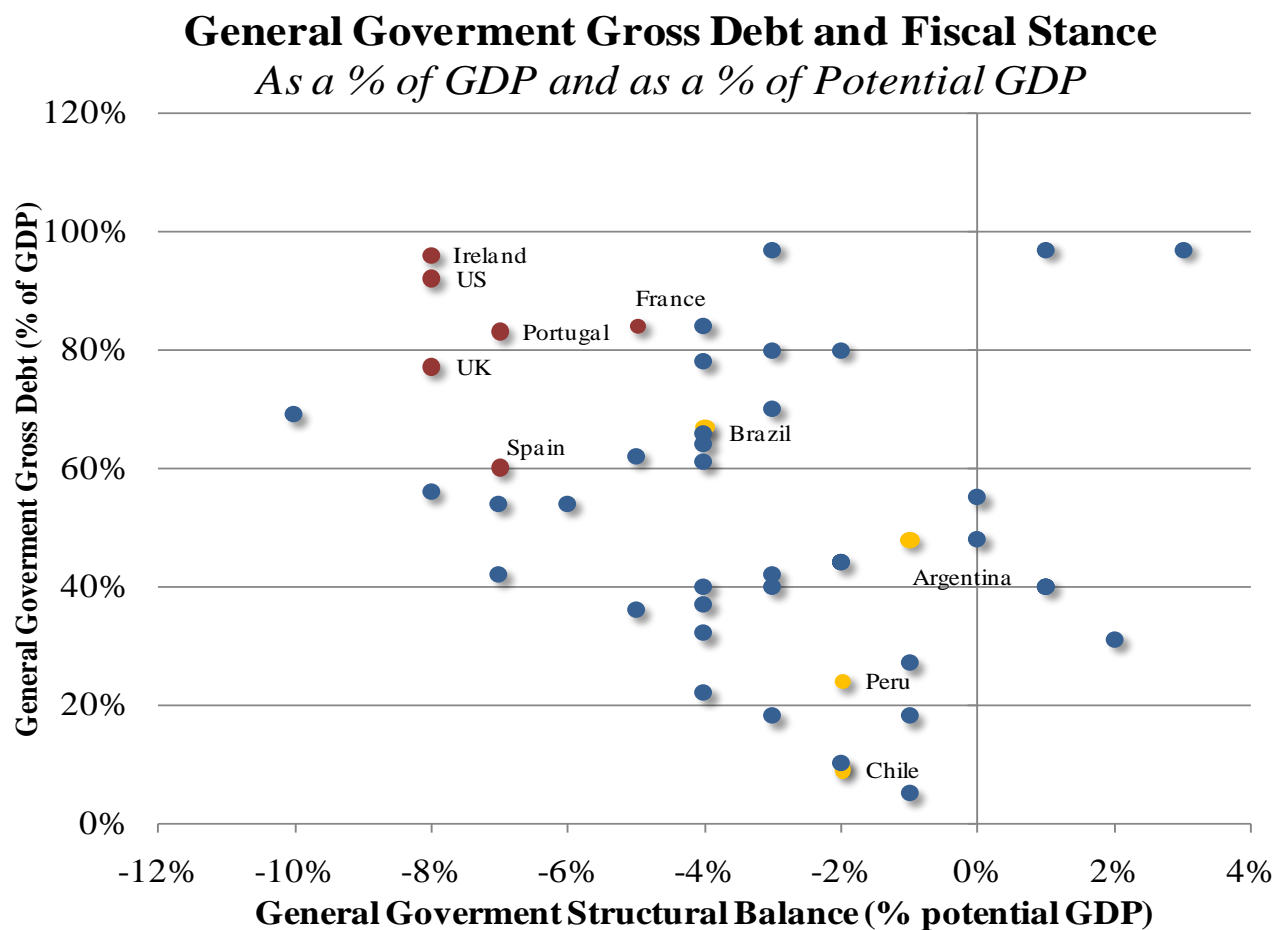
The need to hone the macro prudential policy agenda

- Avoid contributing to amplification – don't rock the boat
 - Remove pro-cyclicality in macro and *traditional* regulatory policy
 - Allow prudential buffers to be true buffers – i.e., to be used without penalty during downswings (Goodhart, 2010; Hellwig, 2010)
 - Remove deeper pro-cyclical factors, such as currency mismatches and social moral hazard (expectation of bailouts or “Greenspan put”)
- Enhance financial system resiliency to cycle – build a better boat
 - Add more, systemically-oriented buffers (liquidity and solvency)
- Dampen the cycle – tame the (excess) amplitude of the waves
 - Incorporate an explicit dampening function into MMP design
- Nip the gestation of adverse financial amplifications in the bud
 - Induce the internalization of externalities and prevent buildup of exuberance (Pigovian taxes, approval protocols for innovations)

Rising Global Uncertainty and Risks

The European Epicenter

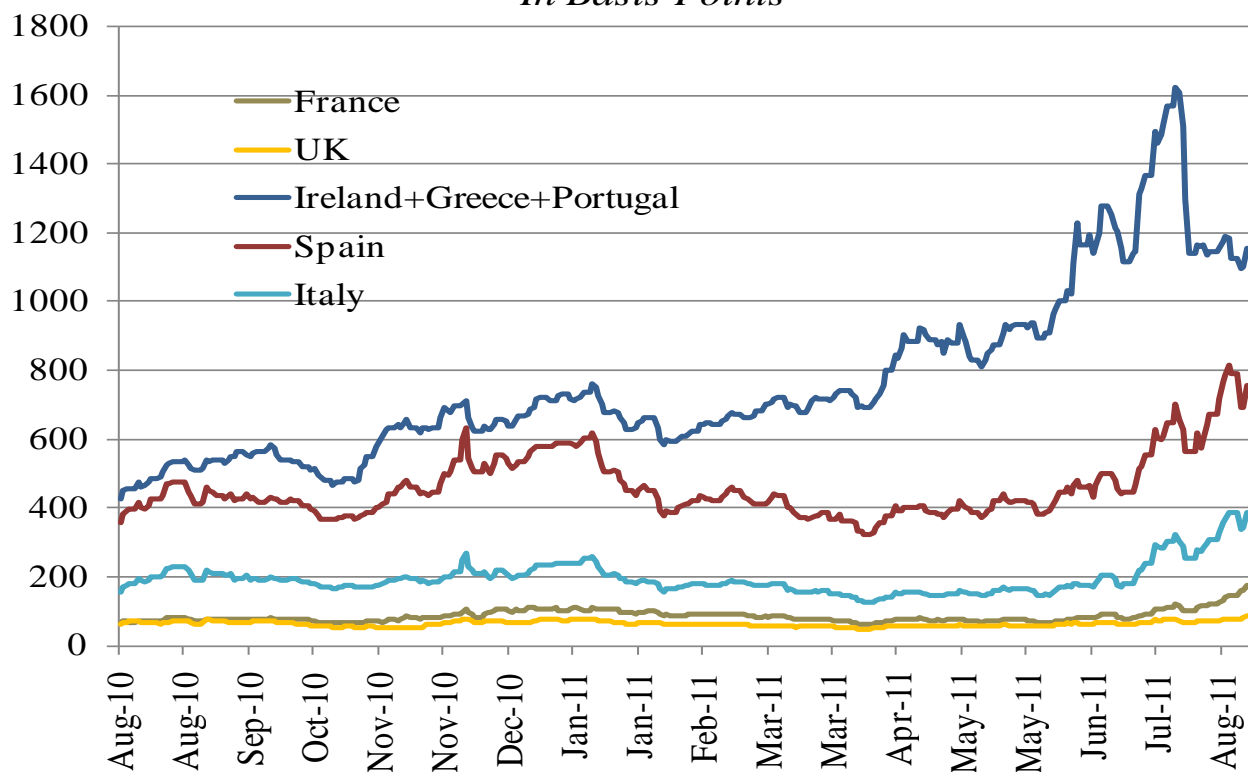
Deeper and broader concerns about debt viability



The European Epicenter

From drama to trauma

CDS (5 years) in Europe
In Basis Points

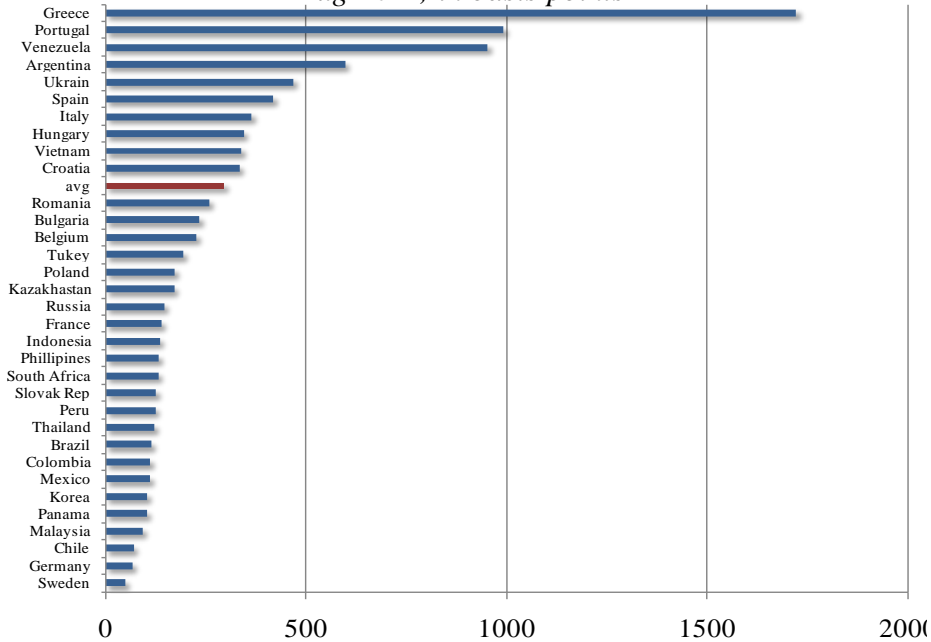


Note: The average CDS is computed for Ireland, Greece and Portugal. Source: Bloomberg

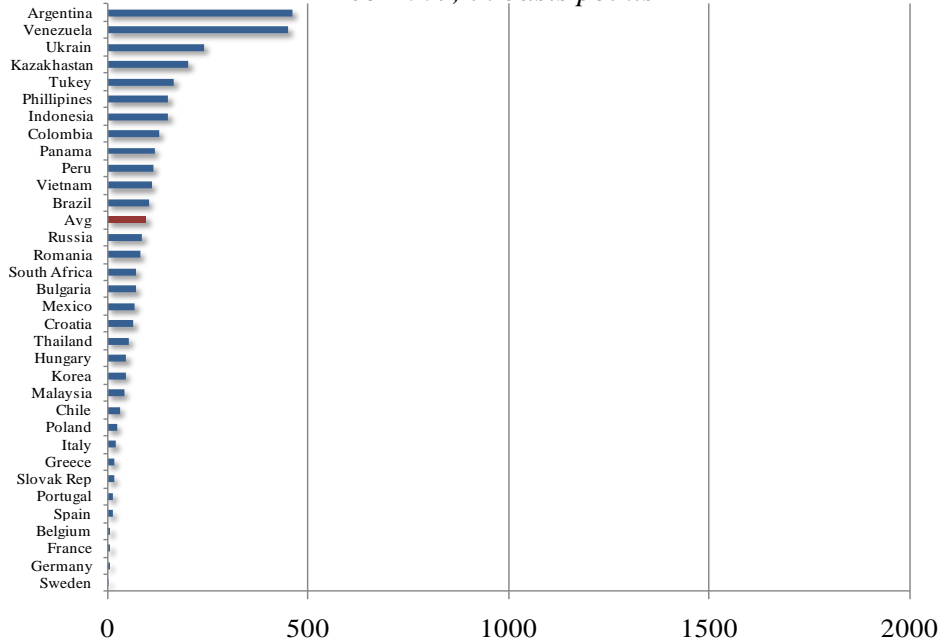
The European Epicenter

Reversal of fortune!

Global Sovereign CDS
Aug-2011, in basis points

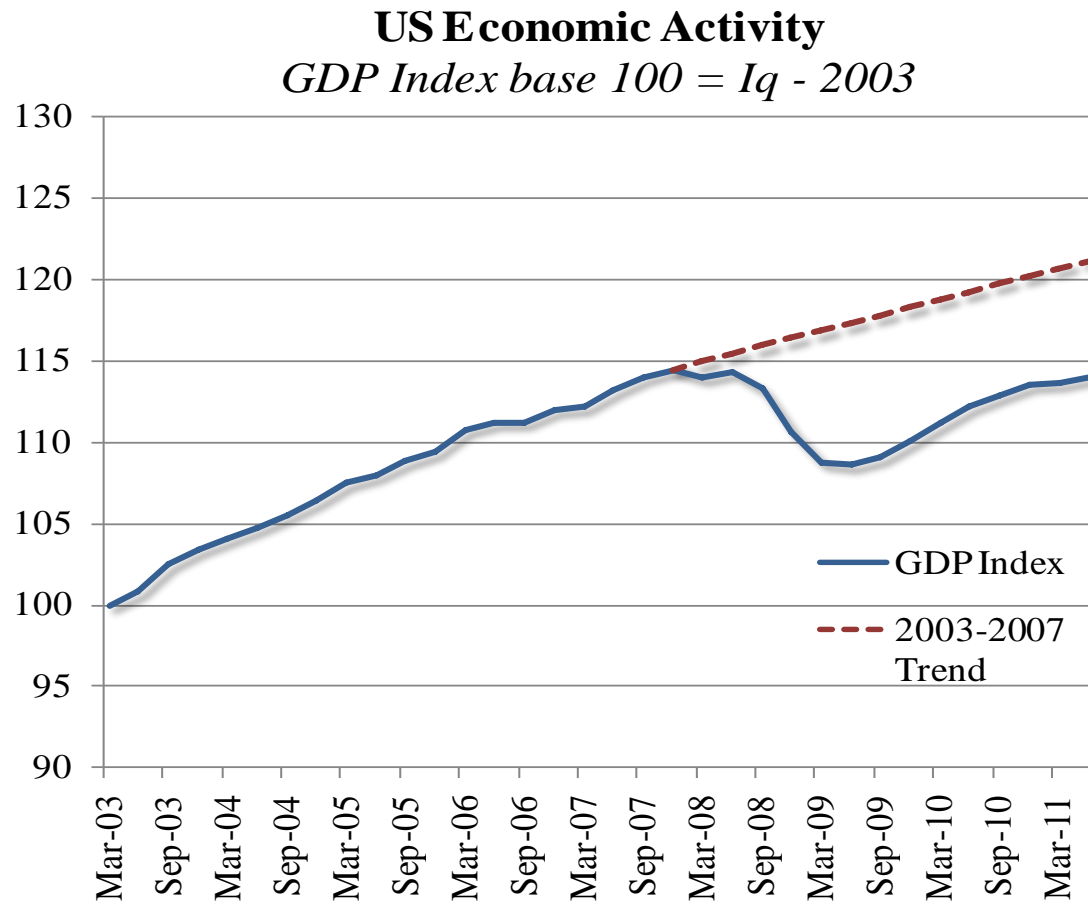


Global Sovereign CDS
Dec-2007, in basis points



The U.S. Epicenter

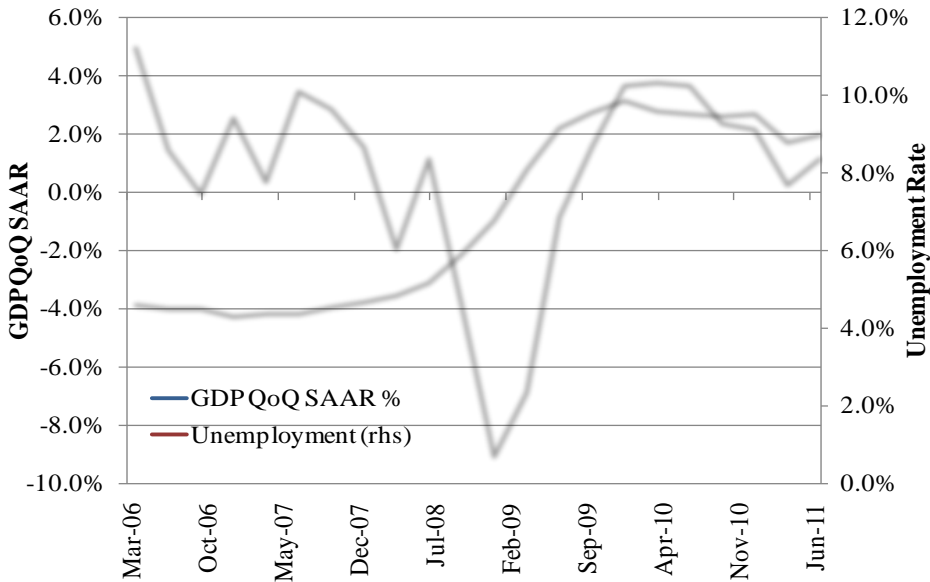
Still well below potential and a risk of a double dip



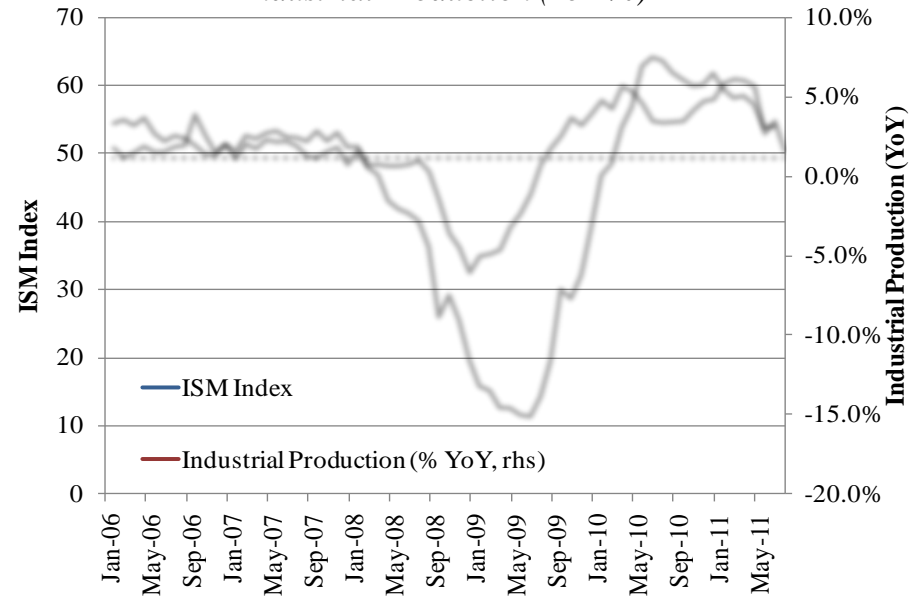
The U.S. Epicenter

A threat of a double dip? Keynes or Fischer?

GDP and Unemployment in the US
GDP QpQ SAAR %, Unemployment as a % of



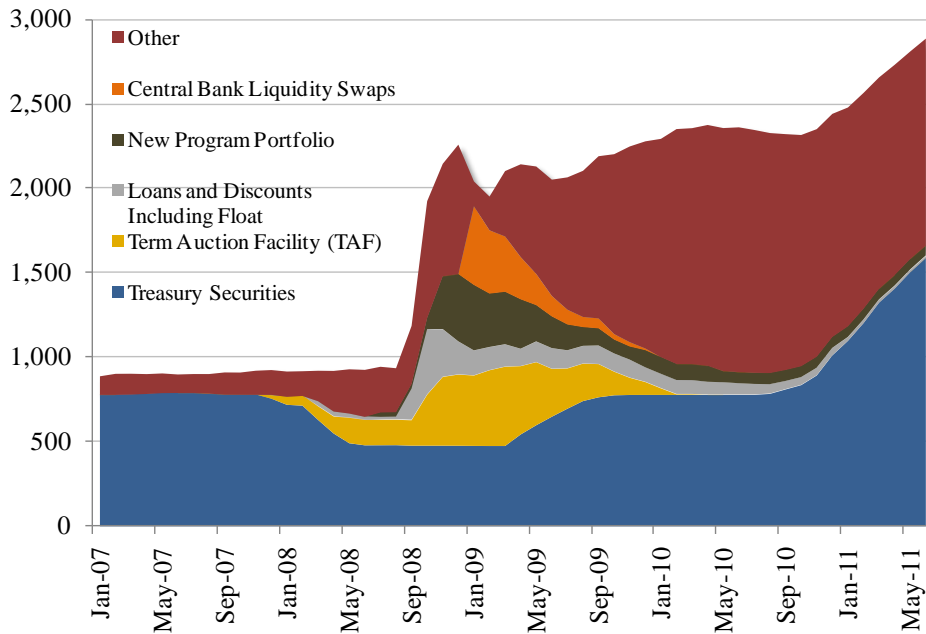
Industrial Production and ISM Index
Industrial Production (YoY %)



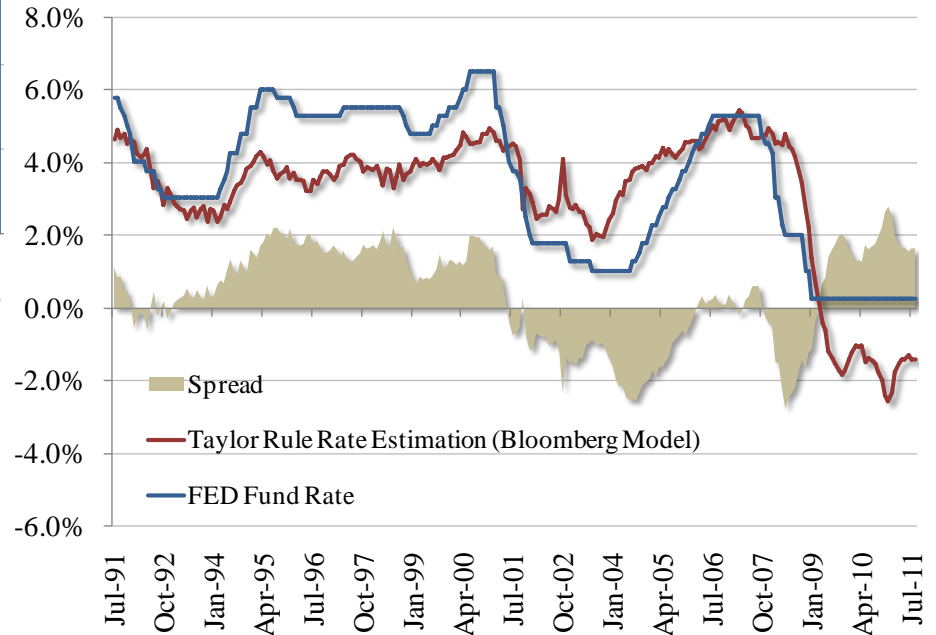
The U.S. Epicenter

Narrowing room for policy maneuvering

The FED Balance Sheet - Assets Side
Factors Affecting Reserve Balances, US\$ Billion



FED Funds Rate and Taylor Rule Estimation

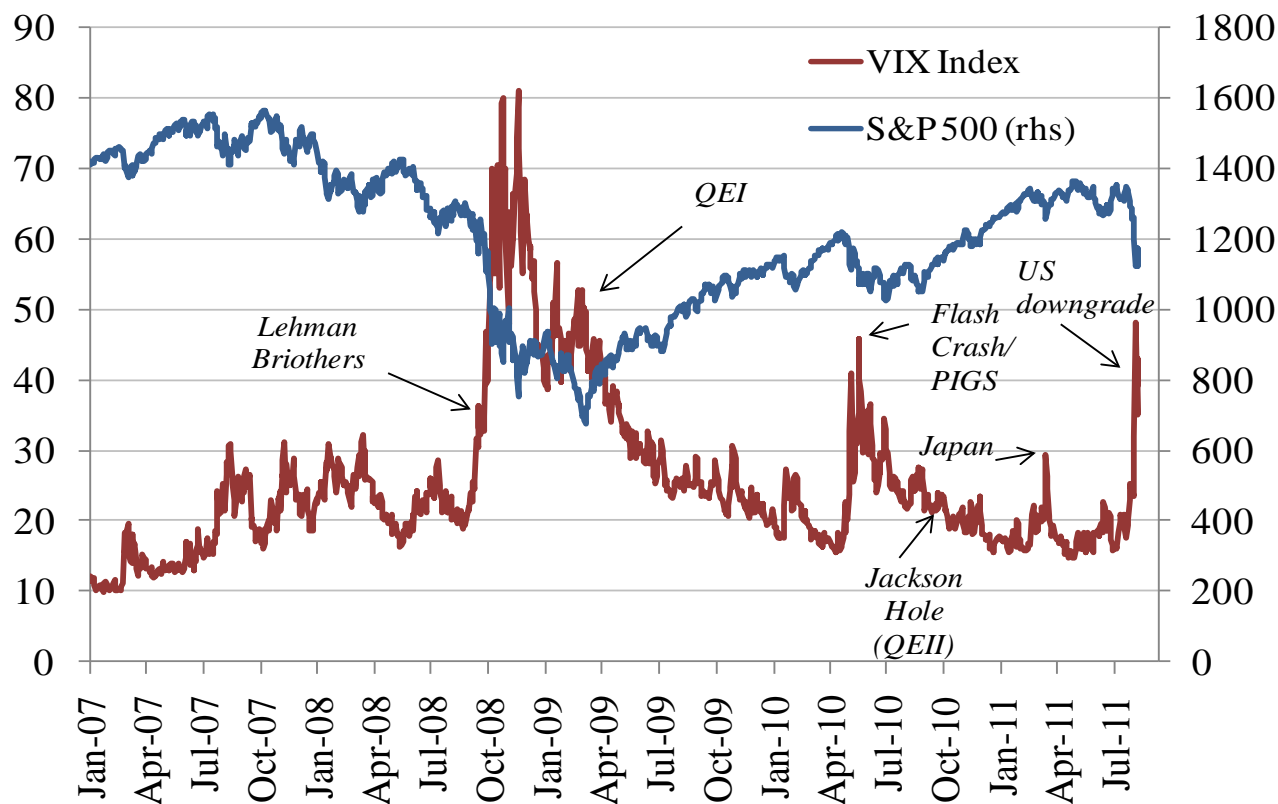


The U.S. Epicenter

The downgrade and the swing in market sentiment

Market Trends and Volatility

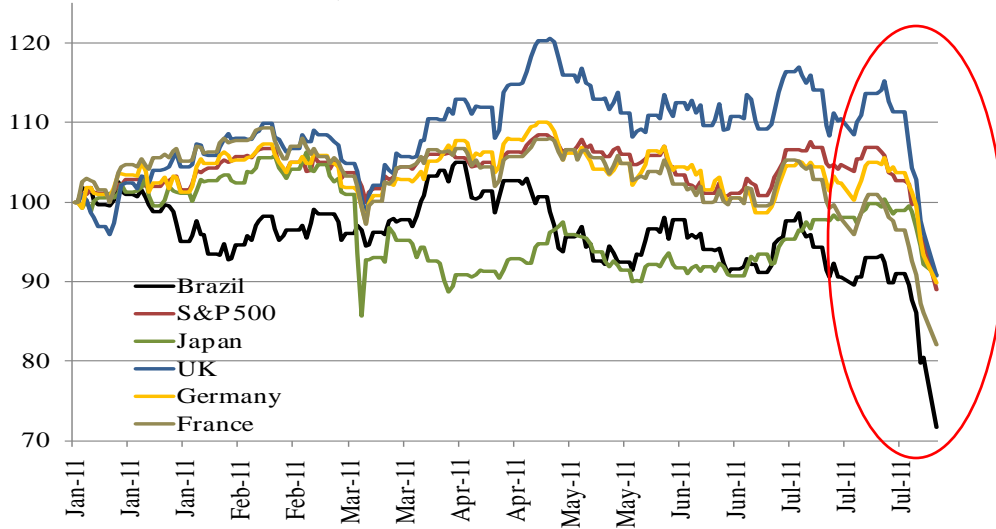
VIX Index and S&P 500



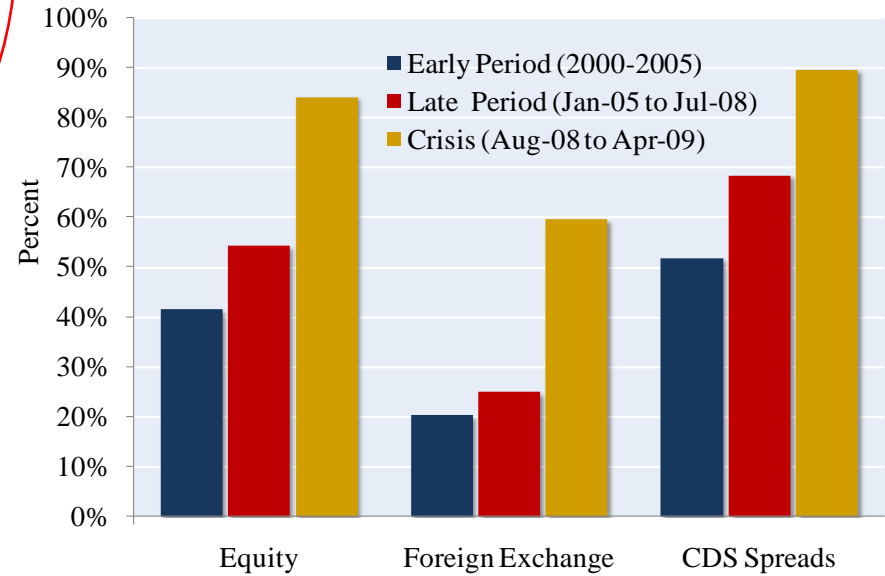
The U.S. Epicenter

The downgrade and global financial coupling

Stock Markets: 2011
In USD, Index base 100 = Jan - 2011



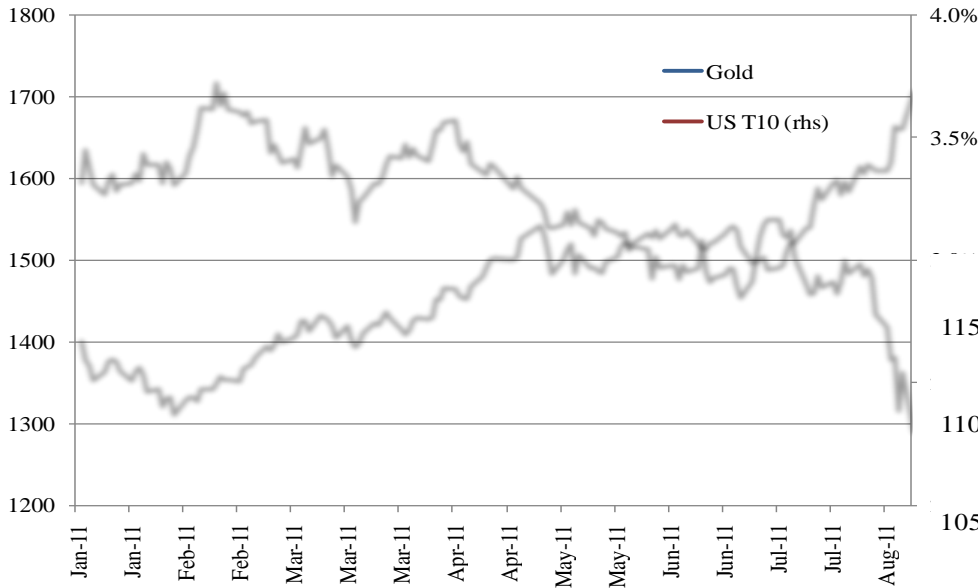
Emerging Market Asset Returns and Common Factors
Average R-Squared from Country Regressions



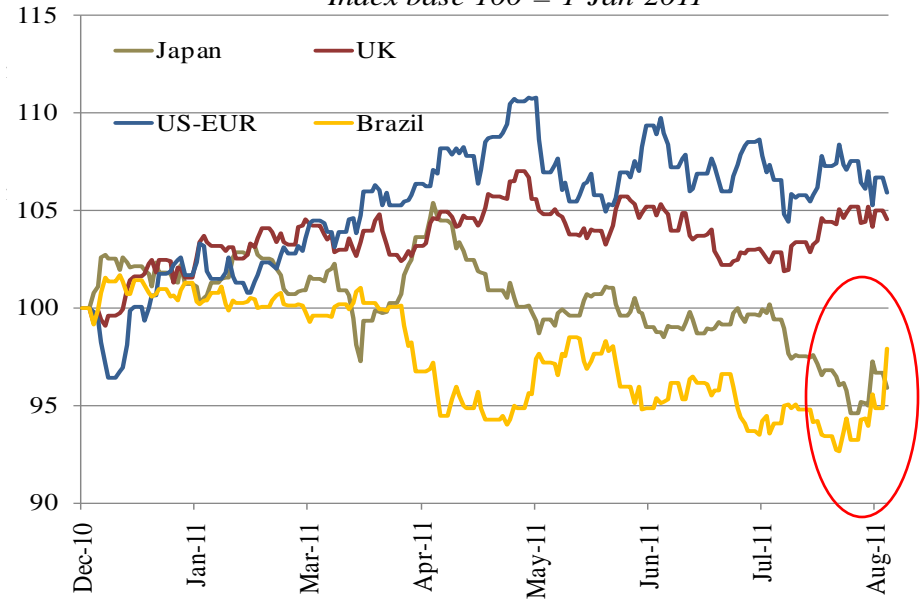
The U.S. Epicenter

Downgraded but still the safe haven

Gold and US T10
2011



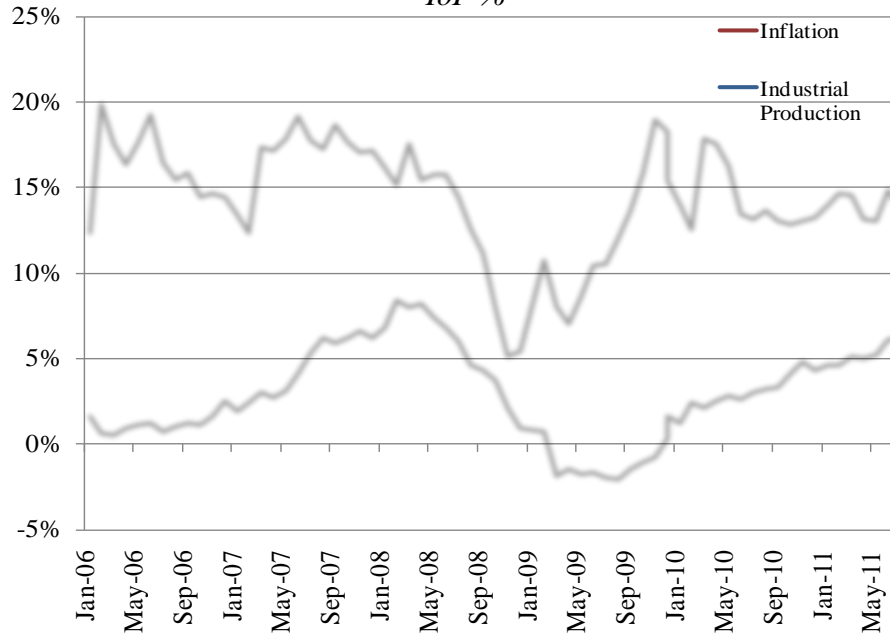
Currencies: 2011
Index base 100 = 1-Jan-2011



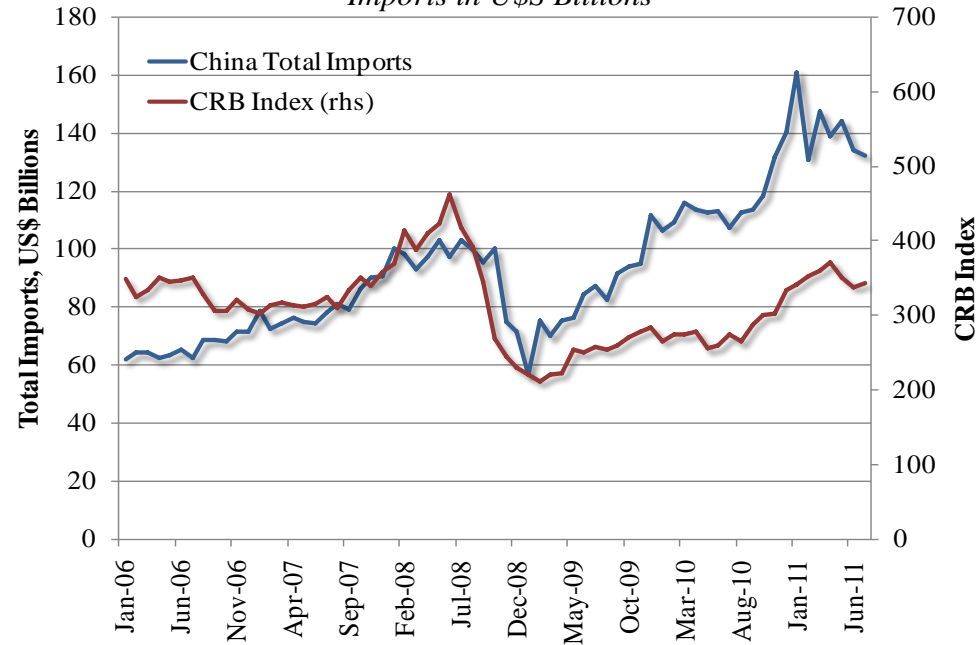
The China Epicenter

Danger of an abrupt adjustment?

China: Inflation and Industrial Production
YoY %



China Total Imports and CRB Index
Imports in US\$ Billions



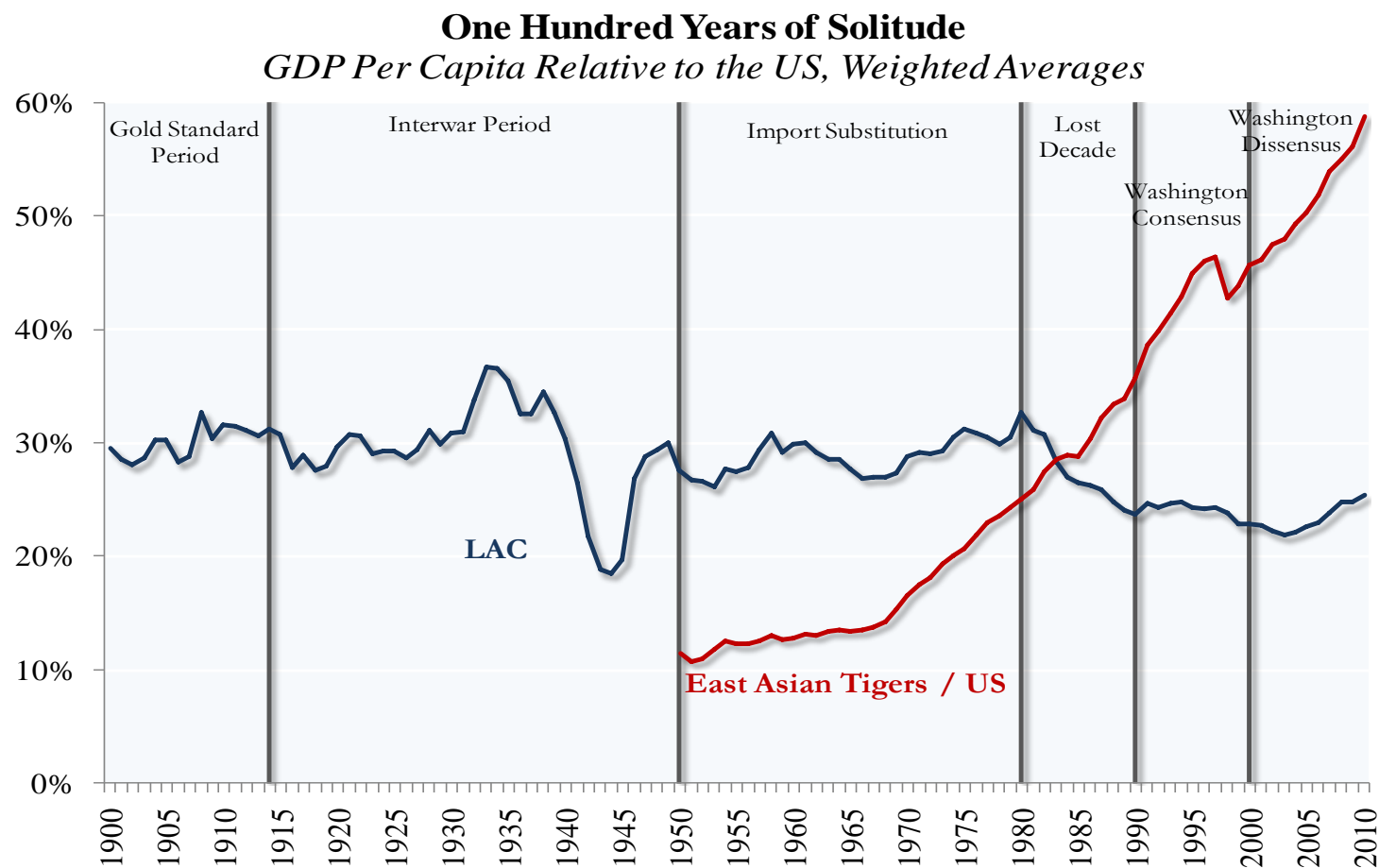
Whither LAC?

Benign scenario: real decoupling continues

Can LAC turn cyclical recovery into higher trend growth?

- Successful management of the cycle is essential to break free from the historical boom-bust pattern
- LAC bumps against *structural speed limits* at comparatively low growth rates
 - Productive capacity in LAC lacks the efficiency and flexibility to accommodate robust long-run growth rates
- Could the region turn natural resources into a blessing?
 - Saving – for stabilization and asset building
 - Diversification – avoiding the “enclave” syndrome
 - Institutions – avoiding corrosive effects of rent-seeking

LAC has experienced 100 years of growth solitude



Note: The group of East Asian tigers includes Hong Kong (China), Indonesia, Malaysia, Republic of Korea, Singapore, Thailand, and Taiwan (China). Maddison (2007-2009) was used from 1900 to 2006. We used the Real Per Capita GDP growth from WDI to calculate the levels from 2006 to 2010. Source: LCRCE Staff calculations based on Maddison (2007, 2009) and WDI

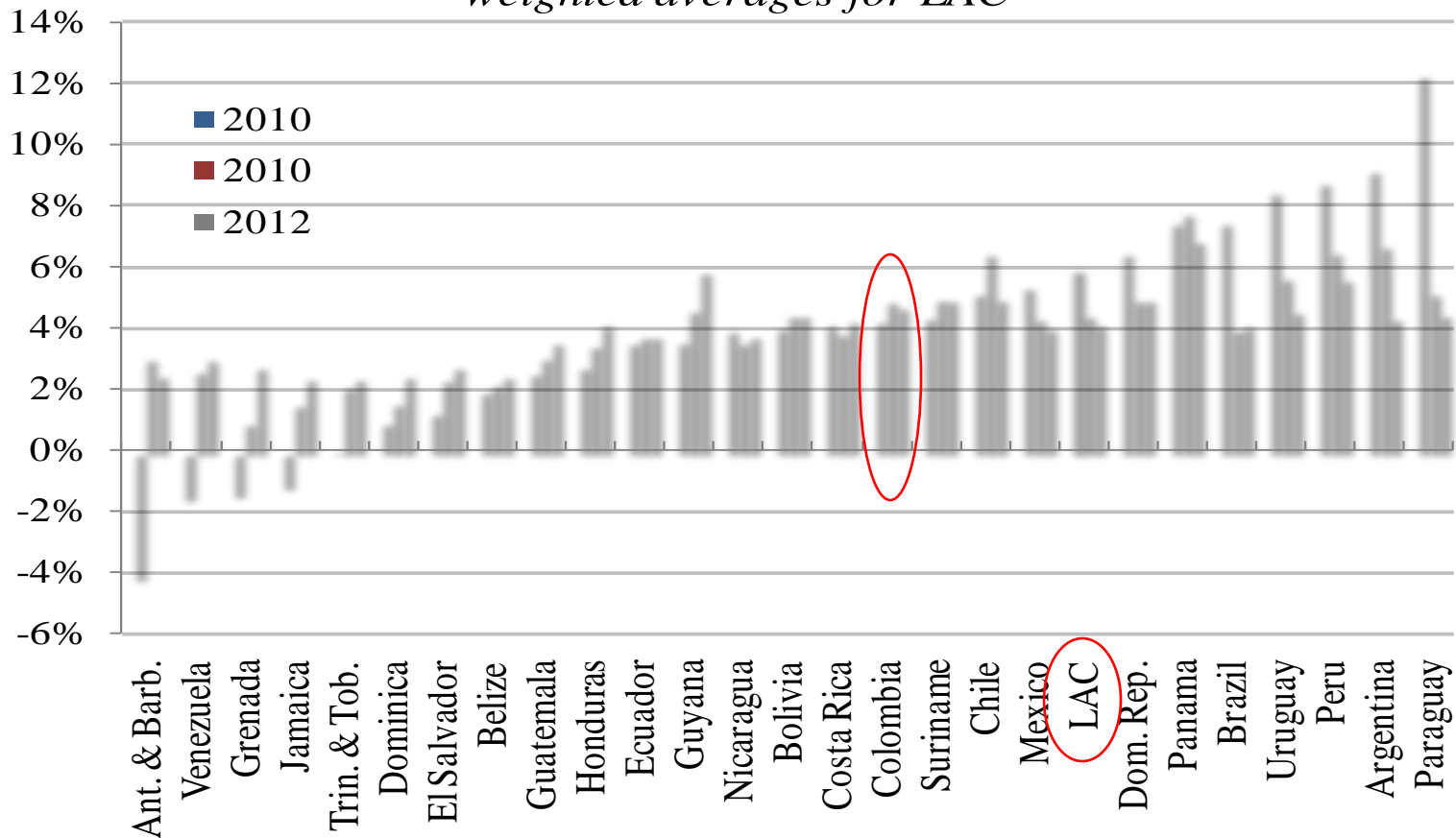
Bad scenario: global downward re-coupling

How much can LAC's new "immune system" resist?

- Robust monetary policy frameworks in LAC, mostly
 - First line of defense in shock absorption: e-rate flexibility and countercyclical monetary policy
- How good are LAC's fiscal buffers?
 - Comfortable public debt levels but now is the time for fiscal savings
- How good are LAC's financial system buffers?
 - Strong capital and liquidity positions
 - ... but have systemic risks been brewing in the past year or so?
- How good are LAC's social safety nets?
 - Ability to scale up social assistance programs varies widely in the region
 - Social insurance frameworks are the weak link

So far, no revisions in growth forecasts for LAC...

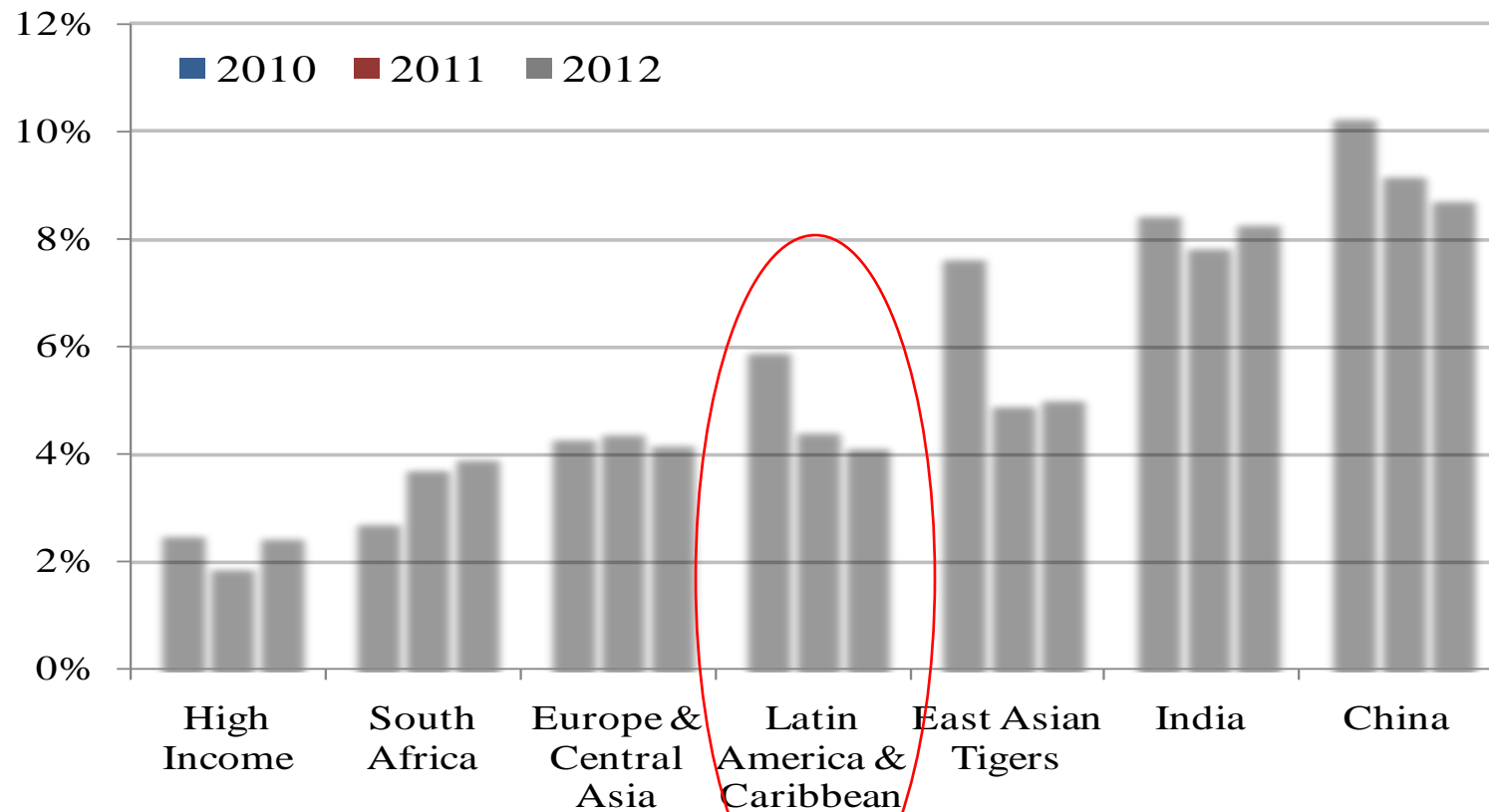
Actual Growth and Growth Forecasts: LAC Countries
weighted averages for LAC



... and LAC is expected to continue to perform well in comparison to other EM regions

Real GDP Growth Forecasts Around the World

Annual Real GDP Growth Rate, Weighted Averages



Thank you